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Global Equity and International Fund Strategies
Third Quarter 2016 Review

Global Macro Review

We recently had the good fortune to attend a leadership lecture featuring Dominic Barton, the global managing director of McKinsey, a global consulting company. Barton, in his very Canadian self-deprecating manner, provided an interesting overview of how different countries can find stability and growth in an age of disruption. The overriding theme is that the next twenty years will be some of the most disruptive and exciting that we have seen, driven by four global forces: (1) shifting economic power to Asia, (2) accelerating technological change, (3) the aging population, and (4) system-wide transformation where the public's perception is based on emotion rather than fact. We definitely witnessed this transformation with the Brexit vote and the recent rejection of ceasefire between the Columbian government and FARC.

A phrase in the lecture that resonated with us was the ability to have a "telescope and microscope perspective." The most attractive companies are those that have a vision of the future and assess how those four global forces will impact their business while still being able to manage their day-to-day operations in an efficient manner. The message Barton was delivering is not new; that is, companies will need to be forward thinking to deal with the potential disruptions in order to remain relevant, largely due to the dizzying pace of technological innovation. The differentiating factor of companies that are able to manage their way through various disruptions or perhaps are disruptors themselves will be found in the leadership of the company; these leaders are selfless, resilient, decisive and driven by purpose. Our approach in selecting companies addresses this by choosing those that keep investing to be the dominant player in their field. For example, Essilor, according to Forbes is considered one of the world's most innovative companies where it has steadily increased their global market share of ophthalmic lenses to 40% with their many advances in lens technology. Another strong secular trend we believe in is automation. Keyence, one of our Japanese holdings and another one of Forbes most innovative companies, is an innovative leader in the development and manufacturing of industrial automation and inspection equipment worldwide. We expect applications where Keyence products are necessary will be increasingly important with the secular growth in automation.

Yet, the reality is the world remains in a low growth environment from weak investment due to tepid private sector confidence, stagnant productivity and growing corporate debt levels. Earlier this week, the International Monetary Fund (IMF) forecast 3% growth rate for the coming year. This growth rate is aided by the faster growing emerging markets hindered by political risk in advanced economies. Specifically, the IMF is expecting the advanced economies, along with the US to grow 1.6% this year and the UK economy to grow 1.1% in 2017 which is half the rate it predicted before the Brexit vote. In the US, consumption growth has remained strong but there is continued weakness in non-residential investment reflected in the decline in capital spending in the energy sector and the negative impact of the strong dollar on industrial demand.

In the short term, another concern corporations are dealing with in addition to the slow economic growth is the rise in political populism in many countries as this could lead to adding tariff barriers and currency wars. This in turn leads to additional uncertainty in the global economy. These measures are featured in US presidential candidate Donald Trump's platform whereby he has proposed raising tariffs on China and Mexico. The IMF's managing director, Christine Lagarde addressed concerns over restricting trade and reducing openness, indirectly hinting at Brexit and Trump. This low growth environment seems to feed and reinforce the loop of a weak economic environment and political instability.

The other key issue addressed by the IMF is the anti-deflation policies spearheaded by various global central banks. They seem to question the viability of the banks' policies given their lack of effectiveness in certain areas and encourages other measures to increase demand. The IMF is suggesting a more "comprehensive package consisting of a more growth-friendly fiscal policy...

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along with demand-supportive structural reforms and measures aimed at addressing weaknesses in bank and corporate balance sheets...in mitigating the risk of protracted weak demand and low inflation." There are no improvements in Japan despite their significant monetary policies.

While central banks globally provide accomodative policies, one of the consequences is the low and negative interest rate and thus compressing bank profitability. While baby boomers rely on interest income and chase yield, they are being negatively impacted by the decline in interest rates. In addition, there may be an issue around a growing deficit in pension funds, given that low rates increase the present value of the liabilities.

We now know that the UK will begin to exit the European Union in March, 2017. As we discussed in prior quarterlies, the key underlying issue about Brexit was taking control of immigration and this appears to be a more important issue than maintaining full access to the country's largest trading partner. The immediate reaction was for the British pound to reach a post-Brexit low. More than 71% of revenue from FTSE 100 companies come from outside of the UK and therefore, the weaker pound will boost corporate earnings that are reported in sterling which will lead to strong market prices, as long as the multiple for these companies remains the same. We are still experiencing the aftermath of the Brexit vote and the final impact will take years to assess. The latest assessment by consulting firm Oliver Wyman is that there will be an estimated loss of 35,000 financial-services jobs and a further decrease of 40,000 industry-related jobs and £10 billion in tax revenue. In the coming months, we shall undoubtedly see many different numbers, depending on whether the sponsor of the study is for or against the UK leaving the EU.

Portfolio Review

Stocks around the world fared well during the third quarter after the shock experienced after the surprise Brexit vote at the end of June. The market seems to pivot between investor sentiment and trying to predict the actions of central banks globally. Markets underwent a sector rotation where Financials and Commodities experienced strong performance. Towards the end of the quarter, energy stocks were aided by the announcement by Organization of the Petroleum Exporting Countries (OPEC) to agree on a deal to control production. There is no certainty this agreement will be honored based on past behavior and thus, we remain cautious on the energy sector.

The Global Equity Portfolio and International Fund are underweight in the financial sector. While this underweight position has been beneficial to the year-to-date performance, it was a detractor to performance in the third quarter. On a fundamental basis, we have difficulty finding a high number of financial institutions meeting our investment criteria while ensuring the banks have adequate level of capital. There are general concerns about the health of the European financial sector post the US authorities proposed a US$ 14 billion fine on Deutsche Bank for their inappropriate sales of mortgage-backed securities. This sort of volatility points to the fragility of the banking industry. In addition, banks in Europe and Japan continue to be under pressure in an environment where their respective central banks continue to keep rates low or are even in negative territory. US banks, on the other hand, have record capital and will benefit from the possibility of the Federal Reserve raising rates.

C$, %	Q3	Year to Date	One Year
Global Equity Portfolio Performance as at September 30, 2016			
Global Equity Portfolio	4.2	-1.6	5.7
MCSI World	5.6	0.1	9.0
Value-Add	-1.4	-1.5	-3.3

Our **Global Equity** portfolio had a cash level of 12% which was the major detractor to performance this quarter. The poor performance of Liberty Interactive was the other detractor to the performance in the quarter. Although Liberty Interactive reported a solid quarter

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with revenue in-line and earnings before interest, taxes, and depreciation (EBITDA) ahead of expectations, management alluded to deteriorating trends in its US business. This commentary led to a steep decline in the stock price. The Global Equity portfolio benefited from positions in Schweiter, Nidec, Abbott and Fresenius SE. The portfolio also benefited from not having any exposure to the two worst performing sectors, Utilities and Telecommunication .

C$, %	Q3	Year to Date	One Year
International Fund Performance as at September 30, 2016			
International Fund	6.0	-1.2	4.5
MCSI EAFE	7.6	-3.5	4.3
Value-Add	-1.6	2.3	0.2

During the quarter, the key detractors in the **International Fund** were the high cash allocation along with the underweight in the two strong sectors in the Financial and Material sectors. The Fund's overweight allocation in Information Technology was a key contributor in the quarter. Certain companies, namely Nidec, Schweiter, Coloplast and Fresenius SE were positive contributors to the quarter's performance.

We took advantage of periodic weakness in the market to add a couple of names that have been on our watchlist for a period of time. We bought Luxottica and Wells Fargo while selling Lloyds and Abbott in the Global Equity Portfolio. Similarly, we added Luxottica as a new position and sold Lloyds and Sanofi in the International Fund.

We enjoyed holding Abbott in the Global portfolio for a number of years, mainly for their ability to deliver consistent results and provide dividend growth annually. However, we did not agree with their capital allocation decision of their two most recent acquisitions of Alere and St. Jude Medical whereby they changed the landscape of Abbott. Hence, we took advantage of a recent strength in the share price to exit the position. Luxottica is the world's leading manufacturer of eyewear where it commands approximately 20% of the global optical and sun frames market by value. The Company features a high degree of vertical integration with a global network of manufacturing plants as well as retail outlets such as LensCrafters, Pearle Vision and Sunglass Hut. This represents a significant competitive advantage as it ensures preferred distribution access for their products. It also has a significant manufacturing and distribution scale advantage compared to its competition given it is four times larger than the number two player.

Luxottica operates in an industry where consultants forecast it to grow at 7% compound annual growth rate (CAGR) through 2019. However, we are using a slightly lower than this industry average for Luxottica given their sales exposure more to developed countries. Key drivers for this growth include rising penetration and access to healthcare in emerging markets as well as aging demographics. Luxottica will be a beneficiary of the premiumization trend given their dominance in luxury eyewear. They are also continuing to drive new store growth in non-traditional formats and internationally.

Outlook

There has generally been uncertainty in the markets this year with not much conviction including unpredictability over continued monetary accommodation from the European Central Bank (ECB) and the US Federal Reserve. Those who predicted the US Federal Reserve would raise rates in July are still waiting but the likelihood of them acting in December is over 50%. Prospectively, the ECB may scale back its bond purchases before the scheduled end of its quantitative easing program next March.

Given the extent to which central banks have influenced the government bond markets and asset prices generally, we shall continue to focus on finding

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companies that are global leaders. These types of companies should be able to grow despite a challenging economic environment as a result of their competitive advantages in their business models. The key valuation metrics for the Global Portfolio and the International Fund are shown below. Furthermore, both the International Fund and the Global Equity Portfolio have higher return on equity than its market index reflecting a higher quality profile. In addition, both portfolios have a lower beta, making these portfolios overall less volatile than the market.

	CPWM Global	MSCI World
P/E Forward 12 m	18.3x	15.8x
Net Debt/F12m EDITDA (ex-financials)	0.87	0.53
Return on Equity (adj.)	25.0%	23.0%
Dividend Yield	2.0%	2.6%
	CPWM International	**MSCI EAFE**
P/E Forward 12 m	18.2x	14.6x
Net Debt/F12m EDITDA (ex-financials)	1.57	1.60
Return on Equity (adj.)	23.5%	17.4%
Dividend Yield	2.2%	3.3%

In our last quarterly, we were waiting for our holdings to report their second quarter earnings. In most instances, our companies either reported strong or in-line earnings. In a couple of weeks, companies will start to report their third quarter earnings. The market will expect strong profits in order to justify a MSCI World price at 15.8 times forward 12-month earnings compared to 13.6 times over the past decade. There have been areas of softness, especially in the industrial companies reflecting the general weakness in the macro economy. Notwithstanding this, our companies will continue to demonstrate resilience from their continued investment in innovation and vision of future competitive threats to their brand and franchise. Over the long-term, we expect our portfolio companies to project continued growth in their earnings at a rate exceeding the market average and overall, we still believe earnings growth from high quality companies is the key to solid investment performance over time.

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